

ARIZONA CORRECTIONAL INDUSTRIES

Annual Report

Fiscal Year 2006



Recipient of the 2005
Arizona Showcase in Excellence Award



ARIZONA CORRECTIONAL INDUSTRIES

Dear Director Schriro:

I am pleased to present the Arizona Correctional Industries Annual Report for Fiscal Year 2006. Since 1991 ACI was mandated to be self-sufficient, revenues have increased from \$5.7 million to a record \$26.7 million in FY2006. Net Income in 1991 was a loss of \$950,648; 25 years later in FY2006 net income was a positive \$1,484,256.

Inmates assigned to ACI programs worked a total of 3,151,003 hours, an equivalent full-time work force of 1,882 FTE. The ACI work programs enabled inmates to contribute over \$2.3 million in deductions to room and board, restitution and victim's compensation.

ACI remains committed to lead by example, striving to employ inmates in real world business situations, producing marketable products and services for our customers throughout the state of Arizona.

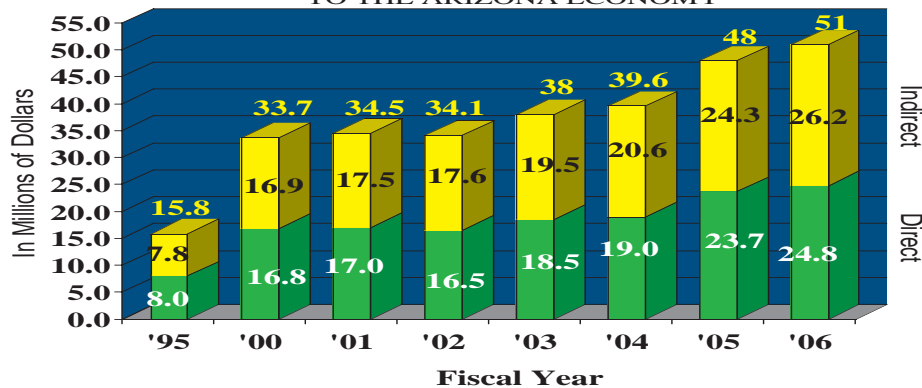
Sincerely,

Bill Branson
General Manager
Arizona Correctional Industries

Mission Statement

To create opportunities for inmates to develop marketable job skills, civility and good work habits through successful enterprises that produce quality products and services for our customers.

ACI CONTRIBUTIONS TO THE ARIZONA ECONOMY



State of Arizona

ACI contributes to the economic prosperity of the State of Arizona in four distinct ways.

First, ACI is a financially self-sufficient program of the Arizona Department of Corrections. The program operates entirely on revenues generated from its business activities.

Second, deductions from inmate wages (including taxes, room and board, and family support) relieve taxpayers of some of the expense of incarceration. During Fiscal Year 2006, inmate wage deductions for room and board totaled \$1,734,514.

Third, in support of its industries and enterprises, ACI purchases goods and services, employs staff and creates demand for goods and services that directly and indirectly benefit the Arizona economy. **During Fiscal Year 2006, these direct and indirect contributions totaled \$51 million. ACI's impact on the Arizona economy contributed to 421 new jobs during that same time (Arizona State University Center for Business Research).** Direct contributions represent expenditures for goods and services, and staff compensation. Indirect contributions represent demand for good and services created by ACI operations and enterprises.

Fourth, ACI supports Community College Work Based Education (WBE) programs by partnering in key strategic programs that provide academic and real world skills in preparing inmates for ACI jobs.

Business Enterprise

ACI produces a wide range of quality goods and services for its customers, and generates significant financial benefits for the State of Arizona. It is our goal that all of our programs train inmates in current demand occupations and reduce the cost of government by providing quality products to Arizona State Agencies.

Inmates

Frequently unemployed or underemployed prior to incarceration, many inmates enter the Department of Corrections with few job skills and poor work habits. Through ACI's diverse operations and programs, inmates learn marketable job skills and experience first-hand the work habits, and work ethic required to obtain and maintain employment upon release. In Fiscal Year 2006, a total of **\$2,385,434** in deductions were taken from inmate wages (see chart below).

INMATE WAGE DEDUCTIONS Distribution by Type

Room and Board*	\$ 1,734,514
Taxes	\$ 99,712
Dependent Support	\$ 41,184
Victim's Compensation	\$ 101,633
Court Ordered Restitution	\$ 361,413
Alcohol Abuse and Treatment Fund	\$ 40,080
SB 1291	\$ 3,533

Total \$2,385,434

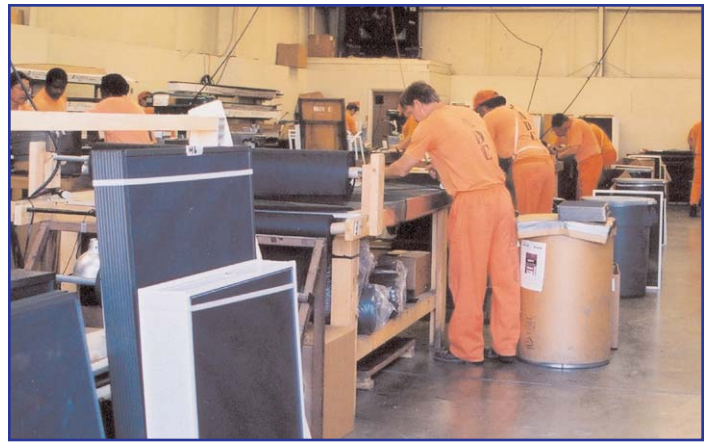
* Inmate contributions deposited into the State General Fund.

Institutions ACI promotes safety and security by serving daily as an incentive for inmates to engage in model behavior. ACI is selective and only employs inmates whose institutional conduct is exemplary, have an exceptional work ethic, and possess their GED. ACI maintains high standards of work performance and institutional conduct for inmates assigned to its industries.

Customers ACI customers include Arizona State Agencies, schools, cities, county government, private enterprise, non-profit organizations and civilians. They receive quality goods and services at reasonable prices, allowing them to make more cost-effective use of the taxpayer dollars allocated to them. ACI also contracts with the private sector to provide consistent and reliable workers for businesses that have been unable to meet their work force requirements through the traditional labor market.

Administration ACI currently has 144.5 permanent positions. This includes 45 Limited Industrial Production Specialists (IPS) that were created to assist with the security function in each shop. ACI exceeds the national average of revenue per FTE by 72%.

Work Based Education ACI Supports a number of WBE programs in conjunction with Arizona Community Colleges. These programs provide college level curriculum for a wide variety of demand occupation programs ranging from Graphic Arts to Automotive Technology. This hand-on model replicates in every way real production environments.



ACI Quality Initiative

ACI is in its third year of quality initiatives. In December 2005 ACI was awarded the Showcase in Excellence Award by the Arizona Quality Alliance (AQA). The next step was to apply for the Pioneer Award for 2006. ACI was chosen as one of the finalists and is currently receiving a quality audit from the AQA.

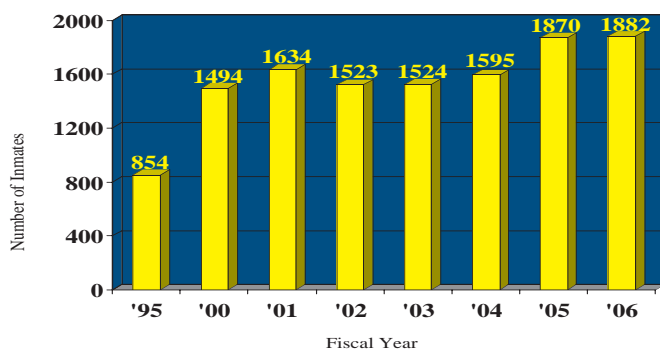
In 2006 ACI began implementation of quality sampling and data measurement throughout the organization. All employees participated in three quality training programs, that included developing projects and metrics to help evaluate the processes at ACI. This includes ACI Owned and Operated businesses as well as all administrative functions.



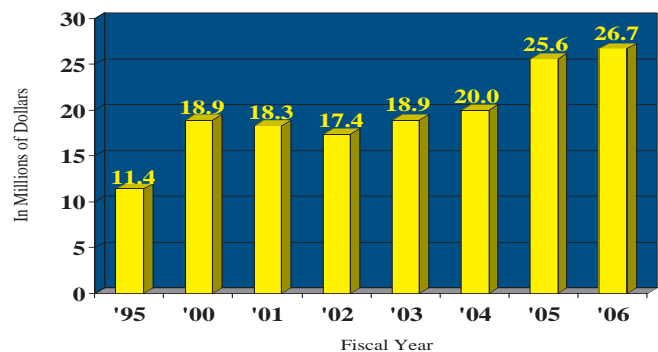
ACI completed more than 800 hours of quality training in 2006. Arizona Quality Alliance Audit Team was on-site for three days to review and validate processes and procedures. ACI is moving closer to the Malcolm Baldrige Award criteria which is recognized nationally throughout the quality network. ACI has established goals of Sigma Four which equates to a 99.4% success rate on all processes.



INMATES EMPLOYED
(Monthly Average)



HISTORY OF REVENUE



ACI Operations Profile

ACI Enterprises consist of five kinds of operations: Owned-and-Operated, Private Sector, PIECP Programs, Governmental Agreements and Work Based Education

Owned-and-Operated

ACI operates 16 different businesses plus an inmate retail store. ACI manages each operation, staffed by a Production Supervisor or Manager, organized regionally under the direction of three regional managers. In support of the owned and operated businesses there are administrative, warehouse, delivery, and maintenance functions that are filled by inmates under the direct supervision of ACI Staff. There are also three installation teams that support the delivery, setup, and warranty repairs of ACI products. In FY2006 there were an average of 836 inmates working daily in support of these business operations.

Manufacturing: Bakery, Bedding, Furniture, License Plates, Garments, Signs, Wood/Metal Refurbishing, Metal Fabrication and Kit Manufacturing.

Service: Graphic Arts, Data Fulfillment, Installation/Support Service, Office Support, Retail Outlet, Copy Service and Warehousing.

Agriculture: Crop planting, irrigation, maintenance and harvesting.

Private Sector

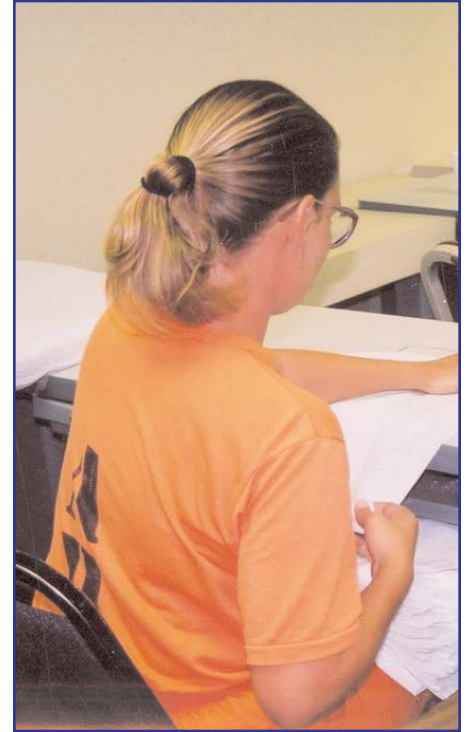
ACI furnishes workers for private enterprises that are unable to meet their work force requirements through the traditional labor market. Some of these businesses have established operations within prison walls, while others have operations in the community, with eligible inmates transported to and from the work site. Currently there are 938 inmates working in the Private Sector Programs.

Prison Industry Enhancement Certified Program (PIECP)

Currently ACI has four Department of Justice approved programs employing as many as 180 inmates. ACI received a satisfactory audit from the Bureau of Justice in July 2005. Inmates worked more than 170,000 hours in FY2006.

Governmental Agreements

ACI provides beneficial services to Arizona State Agencies such as the Motor Vehicle Department and Cotton Research Council.



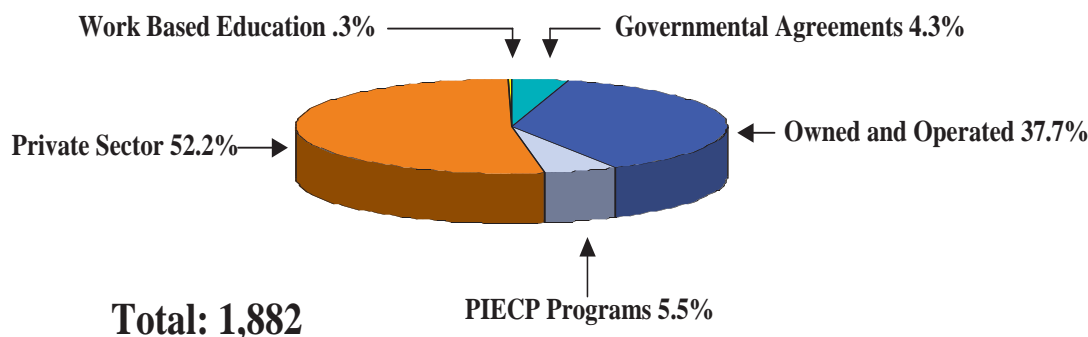
ACI has a long term relationship with the Arizona Motor Vehicle Department. ADC operates with MVD three call centers for inbound, level 1 information calls to the department. 83 inmates are employed in the centers, handling over 1.5 million phone calls each year from the citizens of Arizona. ACI has added a new partner, the Arizona Cotton Research Council. The Cotton Research Council employed 30 inmates in two different projects. This is seasonal work but with the success of this first year it is expected to be reoccurring in future years.

Work Based Education (WBE)

ACI supports 13 WBE programs that train inmates in demand occupations. In 2006, inmates throughout the state were involved in WBE and have earned a record 3,201 Certificates of Program Completion.

TOTAL INMATES EMPLOYED IN ALL OPERATIONS

(Monthly Average)



Inmates worked a total of 3,151,003 hours during FY 2006

ACI OPERATIONS

By Location and Type

Arizona State Prison Complex - Florence

Agriculture
Bedding Factory
Central Warehouse Operations
Transportation Division
Operations Administration
Dixon Farms

Metal Fabrication Factory
Prison Retail Outlet
Consumer Products Division
Industrial Maintenance
License Plate Factory
Eagle Milling Co., Inc.

Arizona State Prison Complex - Perryville

Garment Factory
Data Fulfillment Center
Graphic Arts Division
Morrison Management Specialist
Greater Auto Auction
Crothall Services Group

AZ Department of Transportation --
Motor Vehicle Division (2 Operations)
Televerde (3 Operations)
Hickman's Egg Ranch (2 Operations)
Sunfresh Farms
Carson Trailer East, Inc.

Arizona State Prison Complex - Tucson

Sign/Office Products Factory
AZ Department of Transportation--
Motor Vehicle Division
Eurofresh Bobbin Operations

Farmer's Investment Company
Dixon Farms
Solar Industries

Arizona State Prison Complex - Lewis

American Curb and Vent Common Market Equipment Company Lewis Furniture

Arizona State Prison Complex - Winslow

Kit Manufacturing & Re-Upholstery Plant Eurofresh Commodity

Arizona State Prison Complex - Douglas

Garment Factory Southeast Arizona Medical Center Fiesta Canning

Arizona State Prison Complex -Eyman

Bakery Division Wood and Metal Refurb.

Arizona State Prison Complex - Yuma

Safety Services Co. (3 Operations)

Arizona State Prison Complex - Safford/Fort Grant

Eurofresh

Arizona State Prison - Marana

ESB Modular Manufacturing

Arizona State Prison - Phoenix West

Greater Auto Auction

ACI Central Administrative Office

Installation/Support Services (3 Teams)

Central Office Operations

Copy Service

ACI Annual Meeting

On August 16, 2006 ACI had their first Annual Meeting. Over 100 employees and guests attended. During the morning staff participated in "Strategic Planning Sessions" that focused on ways to improve products, service, and quality throughout the organization.

The afternoon was a review of ACI's financial performance and an awards ceremony recognizing ACI's top performers.



Platinum Award

Bakery - Eddie Gonzalez
License Plates - Darrell Tierney
Labor Contracts - Bruce Farley

Gold Award

Data Fulfillment - Dan Gasper
Sewing Douglas - Jesus Verdugo
Sewing Perryville - John Hawley
Graphic Arts - Randy Bialkowski
Bedding - Peggy Badgett

Silver Award

Metal Fabrication - Jimmy Allen
Furniture - Darrell McGatha

Bronze Award

Signs and Awards - Malcolm McCumber
Upholstery and Commodities - Dan Savage
Agriculture - Richard Carpenter

Sales Person of the Year

Ralph Almaguer

Employee of the Year

Eddie Gonzalez

Special Recognition Awards

Hickman Egg Ranch
Televerde
Arizona Motor Vehicle Department



**STATE OF ARIZONA
DEPARTMENT OF CORRECTIONS
ARIZONA CORRECTIONAL INDUSTRIES
Statement on Net Assets-Enterprise Fund
Year Ended June 30**

Assets	<u>2005</u>	<u>2006</u>
Current assets:		
Cash in bank and on hand	\$ 65,711	\$ 167,561
Cash on deposit with state treasurer	3,378,307	3,051,472
Accounts receivable net	2,594,523	3,119,845
Interest receivable	15,682	14,282
Inventories	3,683,129	3,427,117
Prepaid expenses	<u>140,415</u>	<u>80,749</u>
Total current assets	<u>9,877,767</u>	<u>9,861,026</u>
Noncurrent assets:		
Capital assets, not being depreciated	692,438	692,438
Capital assets, being depreciated, net	<u>1,878,470</u>	<u>2,399,377</u>
Total noncurrent assets	<u>2,570,908</u>	<u>3,091,815</u>
Total assets	<u>\$ 12,448,675</u>	<u>\$ 12,952,841</u>
Liabilities		
Current liabilities:		
Accounts payable	\$ 788,122	\$ 1,475,861
Accrued payroll and employee benefits	211,364	116,970
Accrued compensated absences	235,465	263,250
Other accrued liabilities	<u>564,081</u>	<u>591,885</u>
Total current liabilities	<u>1,799,032</u>	<u>2,447,966</u>
Net Assets		
Invested in capital assets	2,570,908	3,091,815
Unrestricted	<u>8,078,735</u>	<u>7,413,060</u>
Total net assets	<u>\$ 10,649,643</u>	<u>\$ 10,504,875</u>

Unaudited

STATE OF ARIZONA
DEPARTMENT OF CORRECTIONS
ARIZONA CORRECTIONAL INDUSTRIES
Statement of Revenues, Expenses, and Changes in
Fund Net Assets - Enterprise Fund
Year Ended June 30

	<u>2005</u>	<u>2006</u>
Sales	\$ 25,499,193	\$ 26,570,406
Cost of goods sold	<u>21,391,419</u>	<u>22,375,033</u>
Gross profit	<u>4,107,774</u>	<u>4,195,373</u>
Operating expenses:		
Selling	588,531	617,421
General and administrative	<u>1,821,163</u>	<u>2,365,772</u>
Total operating expenses	<u>2,409,694</u>	<u>2,983,193</u>
Operating income (Loss)	<u>1,698,080</u>	<u>1,212,180</u>
Nonoperating revenues (Expenses):		
Investment income	74,405	88,450
Net (Loss) gain on disposal of equipment	<u>(8,659)</u>	<u>19,734</u>
Net nonoperating revenues	<u>65,746</u>	<u>108,184</u>
Income before extraordinary item	1,763,826	1,320,364
Extraordinary item		
Gain on casualty	<u>-</u>	<u>163,892</u>
Net Income	1,763,826	1,484,256
Capital contributions	4,500	-
Transfers out to other state funds	<u>(1,410,086)</u>	<u>(1,629,024)</u>
Increase (decrease) in net assets	358,240	(144,768)
Total net assets, July 1	10,291,403	10,649,643
Total net assets, June 30	<u>\$ 10,649,643</u>	<u>\$ 10,504,875</u>
Unaudited		

STATE OF ARIZONA
DEPARTMENT OF CORRECTIONS
ARIZONA CORRECTIONAL INDUSTRIES
Statement of Cash Flows - Enterprise Fund
Year Ended June 30

	<u>2005</u>	<u>2006</u>
Cash flows from operating activity:		
Receipts from customers	\$ 25,581,994	\$ 27,231,513
Payments to suppliers for goods and services	(11,535,774)	(11,530,910)
Payments to employees	(5,352,106)	(5,799,703)
Payments to inmates	(6,674,437)	(7,803,064)
	<u>2,019,677</u>	<u>2,097,836</u>
Net cash used for operating activities		
Cash flows from noncapital financing activities:		
Cash transfers to other state funds	(1,410,086)	(1,629,024)
	<u>(1,410,086)</u>	<u>(1,629,024)</u>
Net cash (used) for noncapital financing activities	(1,410,086)	(1,629,024)
Cash flows from capital and related financial activities:		
Gain on casualty	-	163,892
Proceeds from sale of capital assets	(308)	19,734
Purchases of capital assets	(530,395)	(965,873)
	<u>(530,703)</u>	<u>(782,247)</u>
Net cash (used) for capital and related financing activities	(530,703)	(782,247)
Cash flows from investing activities:		
Interest received on investments	74,405	88,450
Contributed capital	4,500	-
	<u>78,905</u>	<u>88,450</u>
Net cash provided by investing activities	78,905	88,450
Net increase (decrease) in cash and cash equivalents	157,793	(224,985)
Cash and cash equivalents, July 1	<u>3,286,225</u>	<u>3,444,018</u>
Cash and cash equivalents, June 30	<u>\$ 3,444,018</u>	<u>\$ 3,219,033</u>

Unaudited

STATE OF ARIZONA
DEPARTMENT OF CORRECTIONS
ARIZONA CORRECTIONAL INDUSTRIES
Statement of Cash Flows - Enterprise Fund
Year Ended June 30

	<u>2005</u>	<u>2006</u>
Reconciliation of operating income to net cash source provided by operating activities:		
Operating income (Loss)	\$1,688,348	\$1,212,180
Adjustments to reconcile operating income to net cash used for operating activities:		
Depreciation expense	, 411,598	444,412
Net changes in assets and liabilities:		
Accounts receivable	(84,651)	(523,368)
Inventories	(383,248)	256,011
Prepaid expenses	(16,193)	59,666
Accounts payable	359,334	700,339
Accrued payroll and employee benefits	18,931	(66,608)
Accrued compensated absences	-	15,203
Other accrued liabilities	<u>25,558</u>	<u>-</u>
Net cash source (used) for operating activities	<u>\$2,019,677</u>	<u>\$2,097,835</u>

The following noncash transactions occurred during the year ended June 30:

Building improvements	332,820	-
Construction in progress completed	(332,820)	-
Depreciation expense for discontinued operations	-	-
Accumulated depreciation related to discontinued operations	(246)	-
Capital assets, net of accumulated depreciation	(2,937)	-
Loss on disposal of equipment	(2,937)	-
Donated equipment	-	-
Capital contributions	-	-

Unaudited

ACI Pulls Together Through Tough Times

On August 2, 2005, the Arizona Correctional Industries Central Office was hit with rain and high winds. Late in the evening, ACI senior management received notification of the damage to the building and immediately went into action.

Upon their arrival, they found that the building was flooded in almost nine inches of water. The weight of the water from the rain on the roof had caused 3 sections of the roof to collapse. To complicate the situation, the water main broke due to a 24-inch beam that had snapped. The water main gushed out approximately 10,000 gallons of water per hour over a three-hour period. The damage completely wiped out the computer room where the servers were housed and caused significant damage to two separate areas of the warehouse. Several side beams had also collapsed into the general accounting area.

ACI staff swung into action without missing a beat. Within 24 hours with the assistance of ADC employees around the state, office space was found for 40 employees in 3 different locations. ACI's Information Technology emergency plan was tested and excelled, making recovery of the essential data quickly and efficiently.

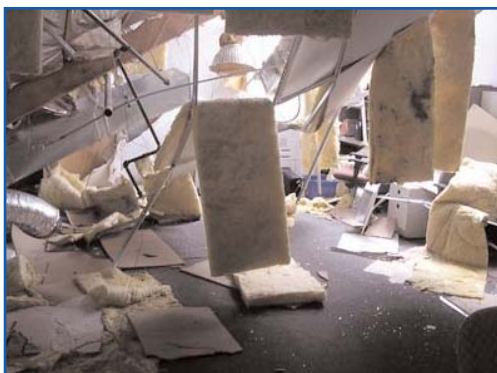
Staff came together as a team, sharing workspace, drying out files, and recovering anything deemed salvageable. Everyone was willing to provide the necessary work to get the main office back to normal operations. Staff worked long and hard to get things packed, cleaned and moved.

It took more than six weeks to return the building to full operation. While staff patiently awaited their return to the building, they continued to make every effort to maintain the high quality of service ACI customers expect. Making the best of a bad situation, ACI used this opportunity to make improvements and make central office even more efficient. The IT Department had been upgraded with new equipment that has the capacity for future growth. The layout of the office lends itself to being more open and organized. The entire building is a showcase for what ACI has to offer in office and modular furniture.

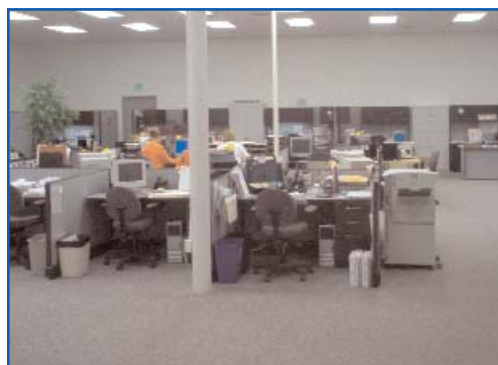
The fiscal impact of the damage on our business was significant; however, despite an estimated loss of half a million dollars ACI still had a record-breaking year. We are proud of our staff and their efforts during this difficult time.



Before



After



CONTACT US:

Arizona Correctional Industries

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***General Manager
and Marketing and Sales***

Bill Branson

Finance and Accounting

Dale Beatty

Labor Contracts

Bruce Farley

Owned and Operated

Bill Foster

Gregg Hillebrand

Al Wesley

Christine Lansford

Work Based Education

Glen Davis

Quality Management

Judi Longmeyer